Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Burton	Analyst:	Norm Catelli	Bill Number:	SB 1255
Related Bills:		Telephone:	845-5117	Introduced Date:	1/09/2002
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: PIT Rates/Increase Maximum Rates To 10% And 11% And Alternative Minimum Tax Rate To 8.5%

SUMMARY

This bill would change the top marginal personal income tax (PIT) rates from 9.3% to 10% and 11%. The bill would also resume an alternative minimum tax (AMT) rate of 8.5%. However, if certain fiscal goals were attained in the future, these rates would be repealed.

PURPOSE OF THE BILL

According to the author's office, the purpose of the bill is to reestablish marginal tax rates to address the current budget shortfall.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and would be operative for taxable years beginning on or after January 1, 2002.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Federal law imposes five different income tax rates on individuals ranging from 15% to 39.1%. Existing state law imposes six different PIT tax rates ranging from 1% to 9.3%. Each tax rate applies to a different level of income known as a "tax bracket."

Federal law provides a personal AMT rate of 26%. Existing state law provides a personal AMT rate of 7%. A taxpayer with substantial income can use preferential tax benefits, such as exclusions, deductions, and credits, to reduce their income tax liability. AMT was established to ensure that a taxpayer who can use preferential tax benefits does not completely escape taxation.

Board Position:			Department Director	Date
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THIS BILL

This bill would establish a new marginal PIT tax rate of 10% for:

- Single filers (including married filing separate) whose taxable income is over $130,000,
- Joint filers whose taxable income is over $260,000, and
- Head of household filers whose taxable income is over $176, 950.

This bill also would establish a new marginal PIT tax rate of 11% for:

- Single filers (including married filing separate) whose taxable income is over $260,000,
- Joint filers whose taxable income is over $520,000, and
- Head of household filers whose taxable income is over $353,899.

These brackets would be indexed for inflation beginning January 1, 2003.

The AMT rate would be changed to 8.5% for individual taxpayers.

These rates would be repealed if the Director of Finance certifies that a reserve fund is established that exceeds 3% of General Fund revenues for the current fiscal year.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

LEGISLATIVE HISTORY

In the early 1990s California faced a severe recession, which resulted in significant shortfalls in the state budget. In response, the state acted to increase revenues and reduce expenditures. As one way of increasing revenues, the state imposed a temporary income tax rate increase in 1991; adding 10% and 11% rates for the highest income taxpayers (*SB 169, Alquist, Stats. 1991, Ch. 117*). This temporary tax increase was in effect for four taxable years and sunset for taxable years beginning on or after January 1, 1996.

During the November 1996 general election, Proposition 217 was submitted to the voters. Proposition 217 would have extended the income tax increase for higher-income taxpayers and allocated the money from the tax increase to schools and local governments. The proposition was defeated by a margin of 50.8% to 49.2%.

OTHER STATES' INFORMATION

Florida does not have a personal income tax. *Illinois* has a flat tax rate of 3%. *Massachusetts* has a split rate, a flat tax rate of 5.6% for most income and 12% for certain capital gains, dividends, and interest. *Michigan* has a flat tax rate of 4.2%. *Minnesota* has a progressive rate with a maximum rate of 7.85%. *New York* has a progressive rate with a maximum rate of 6.85%. All these rates are for the 2001 tax year. The laws of these states were reviewed because their tax laws are similar to California's income tax laws.

FISCAL IMPACT

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

ECONOMIC IMPACT

Revenue Estimate

Based on the data and assumptions below, order of magnitude revenue effects are estimated as follows:

Estimated Revenue Impact Years Beginning On or After January 1, 2002 Enactment Assumed On or After June 30, 2002 Fiscal Years (In Billions)			
	2002-3	2003-4	2004-5
10% and 11% Personal Income Tax Brackets & AMT Rate Increase	$3.1	$3.2	$3.5

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

This revenue estimate is based on the latest Personal Income Tax Model that incorporates the latest available tax returns information and the current Department of Finance forecasts.

This estimate assumes that the proposed 3 percent reserve threshold would not be met in 2002 through 2005 and therefore the proposed 10 percent and 11 percent personal income tax brackets would be in effect for each year.

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